Selling the White House on gold-backed SDRs

by David Goldman

The European Management Forum's annual conference at Davos, Switzerland, goes largely unreported in the American press. During Jan. 30-31, it heard former West German Chancellor Helmut Schmidt, New Zealand Prime Minister Robert Muldoon, and a variety of private economists present one or another scheme for a "world central bank," or a "new Bretton Woods," or similar measures which amount to an International Monetary Fund and Bank for International Settlements dictatorship over world credit. Muldoon, who first raised the slogan "a new Bretton Woods" at the September 1982 meeting of the British Commonwealth, is also the Chairman of the Commonwealth's task force on international monetary reform. He wants a "security council" for economic affairs composed of the leading industrial countries in parallel to the Security Council of the United Nations.

Remote as the Davos events may seem, the elite Swiss club is one of the few places in the world where the debate inside the administration may be aired in the open. Secretary of State George Shultz and his acknowledged "close friend and adviser" Henry Kissinger have combined with the economists of the "New Right" to sell the administration on the ultimate answer to the multi-layered financial crisis programmed to break this spring.

Mundell's proposal

The guru of "supply-side economics" (the man who invented Arthur Laffer), Columbia University Professor Robert Mundell, opened the ideological currents to public view in a Jan. 31 essay in the *Wall Street Journal*. Mundell, associated with the International Monetary Fund for most of his career, for the first time linked the notion of a return to a gold standard—a subject congenial to the belief-structure of Reagan's political base and immediate circle of advisers—to the notion of a world central bank.

Mundell reviews the past 10 years' monetary history, concluding that the world has moved from a gold standard to the "Volcker standard," and notes accurately that the principal result of the destruction of the fixed-rate exchange system was the uncontrolled expansion of the Eurodollar market. He suggests, as previously, that the United States buy and sell gold within specified margins as the foundation of a new system—the 1980 approach proposed by former Bank for International Settlements chief Jelle Zjilstra, or what the Kempites called the "Mundell-Zjilstra Plan."

However, Mundell, who was one of the original theorists of the SDR in the early 1960s, adds the following:

> It may be possible to integrate some of the features of this new gold exchange standard with the activities of a world central bank using the SDR as an instrument for centralization of exchange rates. The world central bank could take the lead in accepting gold from national central banks that wanted more SDRs or in selling gold to those central banks desiring to reduce their holdings of the world reserve currency. The existence of such an institution would go a long way

toward alleviating the current difficulties of debt rescheduling—or worse.

The difficulties of establishing such a bank are easily exaggerated; they are not more insurmountable than the difficulties of setting up the Bank of England or the Federal Reserve System. The path has already been broken by the comparatively successful establishment of the IMF and the International Bank for Reconstruction and Development at Bretton Woods. After 40 years, these institutions are thriving, the more so as the debt crisis deepens.

It is necessary, of course, to bear in mind that it does little good to wish for a system that cannot be implemented. The authorities do not have complete discretion in determining the outcome of an international monetary system that contains its own internal laws of evolution. The fact is that the world in the future will probably contain features of several monetary systems.

We now have features of a world central bank and still have vestiges of a gold standard, which detractors might call an atavism, or barbarous relic. It is, nevertheless, here that I believe the most progress can actively be made, taking the best from the past and linking it with the best in the present. Stabilization of the price of gold would be a gigantic step toward stabilizing the value of international reserves, and the creation of a suitable world central bank would be, over the future, an indispensable instrument for the resolution of the world debt crisis.

Washington under pressure

The link between gold and SDRs is a matter of the "internal laws of evolution" Mundell refers to, i.e., the big setup, in the following fashion: the main loser in a collapse of the oil price will be the market for U.S. Treasury securities, which is the biggest point of vulnerability of the world financial system. At the point of crisis in the Treasury market the reserve basis of all central banks is called into question; and at this point, the "barbarous" relic remains as the principal reserve asset by default.

The supposed "liberals" in the administration around George Shultz are now rallying around Mundell's program for a gold-backed Special Drawing Right, and the "West Coast" conservative group based at Stanford University has suddenly found common ground with the "East Coast Establishment" group at Henry Kissinger's Center for Strategic and International Studies at Georgetown University in Washington.

A close aide to Secretary of State George Shultz, describing Washington's tortuous path toward acquiescence in a world monetary reorganization that would give the International Monetary Fund the powers of a world central bank, characterized the administration's present mood as follows: "These ideas are now filtering into the White House through a variety of mechanisms. George [Shultz] has [Undersecretary of State for Economic Affairs W.] Allen Wallis pumping things into the White House, where Allen has excellent contacts. And it will come up at the Conference on World Growth of the Institute for Contemporary Studies—that's the group that Ed Meese is associated with—in Mexico City in late April. This will have a lot of World Bank people; it is being co-sponsored by the U.S. Information Service. There will also be Mexican participation.

"The way an organization theorist would try to describe the process is that there is a dialogue which shapes the domain of perceived options and sets the agenda for the country. Some of this has to do with power and territoriality, some with ideas. The point is that people are beginning to coalesce around the domain of acceptable options for dealing with the crisis."

And a senior administration economist, evaluating the impact of the imminent collapse of the oil price, had this to say: "The oil price problem represents serious problems in the short term. In the medium term, of course, it helps, but if we can't get through the short term, the medium term isn't much good. There is a good deal of feeling in this administration, which I don't share, that the problem is solved, that all of this ad-hockery has solved the problem.

"There is a good deal of pulling back, and a lack of real interest in looking at long-range solutions. So early spring would be perfect timing. At this point it will be clear that nothing has been solved. The Exchange Stabilization Fund and BIS bridging loans to Brazil and Mexico will come due then, and the countries won't be able to pay. There is a very real possibility that the Europeans might break off and set up their own arrangements, and make some sort of deal with the Russians. There's a lot of talk like this going around. But all these ideas come together in this talk of an international central bank.

"The problem, people are saying, is due to the decentralization of decision making. They want greater coordination and an international command economy. None of them say that, because it would arouse opposition; but that's the content of the plan."

Meanwhile, Sen. Charles Mathias is continuing hearings in the Senate Foreign Relations Committee on the subject of the International Monetary Fund; these have escalated from a mere demand that the United States hand over tens of billions of dollars to the IMF, to a demand that it give political authority to the IMF as well.

Carter administration Treasury Secretary G. William Miller, testifying Feb. 2 at Senate Foreign Relations Committee hearings on the international debt situation, called for "an international reserve unit to be used as a reserve asset for deposits and denomination." He also proposed that the International Monetary Fund have mandatory deposits in convertible currencies without waiting for the political process" to augment the IMF's available funds, i.e., direct Treasury handouts to the supranational institution without congressional approval.

The "coalescence around a domain of options" has extended into strange places and remarkable individuals. On Jan. 21, the Cato Institute, the ultra-libertarian Washington foundation linked closely to Friedrich von Hayek's Mont Pelerin Society, sponsored a conference entitled, "The Search for Stable Money." The "only significant speech," as an associate of Professor Mundell said, was delivered by an economist who usually speaks on behalf fo the Third World caucus at the International Monetary Fund, Brazilian Executive Director Alexander Kafka.

The Czech-born Brazilian proposed, as he usually does before credulous Third World audiences, the use of the International Monetary Fund's Special Drawing Rights as a means of increasing international liquidity, a standard Third World demand; except this time Kafka proposed to bring in gold backing for the SDR, moving in towards Mundell's camp at the same time that Mundell took a giant step towards his.

Institutions and timing

Elsewhere in this issue (see Special Report) we elaborate the grounds to expect a rip-roaring financial crisis during April or May, between the summit meeting of the Non-Aligned Nations in New Delhi March 7-11 and the summit of the seven leading industrial nations at Williamsburg on May 28. All that is now required to bring down the banking system, as *EIR* founder Lyndon H. LaRouche, Jr., emphasized in these pages two weeks ago, is a handful of telexes from European banking consortia calling nations that are already in default de facto into default de jure.

Bank of England officials are already describing the Managing Director of the International Monetary Fund, Jacques de Larosière, as "the man on horseback," the "French bureaucrat with a field marshal's baton in his knapsack." Says one IMF economist, "When the crisis hits, someone has got to pull it all together; someone has got to go to the governments and make the big play. A new institution won't fly. It's got to be de Larosière."

A closed conference of the International Monetary Fund on March 25-26 at the IMF's Washington headquarters will brief the Fund's executive directors on the extent to which the current legality of the IMF Charter can extend the operations of the Fund to those of a de facto world central bank. The proceedings of the conference will not be available until afterwards; however, one document now circulating among executive directors makes the following arguments concerning the end of the dollar era and the prospects for the IMF:

> The decline in the role of the dollar lagged behind and has not gone as far as the decline in the dominance of the U.S. economy. . . . The closing of the U.S. gold window on Aug. 15, 1971, was a dramatic event, but it should be viewed as the last act in a long process that transformed the gold-dollar standard into a pure dollar standard. . . .
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> The successful "recycling" of OPEC surpluses had demonstrated that liability financing was an option open to most governments. . . . Now that recycling has ended, however, we can see why so many countries were able to engage in liability financing—why recycling was successful. There were these special reasons:
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> 1) Most of those same countries entered the 1970s with rather light debt-service burdens. . . .
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> 2) The concentration of current-account surpluses was unique, and so was its disposition. A handful of oil-exporting countries were building up huge claims on the outside world, and they chose for various reasons to hold those claims in liquid forms. Thus, banks had large sums to lend just when they were wanted. This set of circumstances would be hard to reproduce—and it did not last. In fact, it fell apart completely.

The document, whose author would not be quoted by name, concludes that reserve-creation through "liability management," that is, short-term borrowing, is finished as a regime, and says that the IMF "is the only agency that can create a reserve asset whose quantity and quality can be controlled precisely—an attribute that we may come to value highly in an increasingly uncertain world."

All that is required to replace the American dollar with the Special Drawing Right, the paper concludes, "can be achieved without a change in existing law or practice. It is thoroughly consistent with the language of Article XVIII, Sec. 1(2): "In all its decisions with respect to the allocation and cancellation of Special Drawing Rights the Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserves assets in such a manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world."

At the appropriate point, IMF Managing Director de Larosière is supposed to walk into President Reagan's office and say something like this: "Mr. President, your IOUs won't pass any more. I've got a deal where your creditors will accept my Special Drawing Rights instead of your Treasury IOUs, which have become a drug on the market. So I am going to buy up all your notes from your creditors. And I want some say about how things are done around here."

Of course, the IMF's SDRs are backed by nothing but the IMF's "institutional credibility"; this is possibly the biggest confidence racket in world history. But the crisis is hitting so fast that it very well might succeed.